

Message Text

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C O N F I D E N T I A L SECTION 1 OF 2 EC BRUSSELS 12360

E.O. 11652: GDS
TAGS: EFIN, EC
SUBJECT: EC MONETARY COMMITTEE MEETING

REF: (A) EC BRUSSELS 11533, (B) EC BRUSSELS 10460, (C) EC BRUSSELS 11
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(D) EC BRUSSELS 11481, (E) 75 EC BRUSSELS 6903

1. SUMMARY: THE EC MONETARY COMMITTEE, MEETING IN BRUSSELS
NOVEMBER 8, DISCUSSED, MODIFIED, AND FINALLY APPROVED TWO
DOCUMENTS, ONE ON MONETARY COMPENSATORY AMOUNTS, THE SECOND ON
THE ECONOMIC SITUATION IN ITALY, AND POLICY CONDITIONS TO BE
FIXED FOR 1977. THE COMMITTEE OPINION SUPPORTS THE CONCEPT OF
REDUCING MCAS BY AUTOMATIC ADJUSTMENT OF GREEN RATES AS
PROPOSED BY THE COMMISSION, WITH A STRONG U.K. DISSENT. IN
ITS REPORT ON ITALY, THE COMMITTEE REVIEWS THE ECONOMIC
SITUATION THERE AND COMMENTS ON ITALIAN PROPOSALS FOR
POLICY GUIDELINES FOR 1977. NO FINAL DECISIONS ON GUIDELINES
OR ON THE LOAN TO ITALY ARE NOW EXPECTED BEFORE YEAR-END.
END SUMMARY.

2. THE MORNING SESSION OF THE NOVEMBER 8 MEETING OF
THE EC MONETARY COMMITTEE WAS DEVOTED TO A DETAILED
DISCUSSION OF A DRAFT OPINION TO THE COUNCIL AND
COMMISSION ON MONETARY COMPENSATORY AMOUNTS (MCAS) WITH-
IN THE COMMON AGRICULTURAL POLICY. AS FORESEEN IN REF A,
THE REPORT REFLECTS THE EIGHT TO ONE SPLIT IN THE
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COMMITTEE IN FAVOR OF AN AUTOMATIC ADJUSTMENT OF GREEN

RATES AS IN THE COMMISSION PROPOSAL (REF B), AS A RESULT OF CONSIDERABLE DIFFICULTIES IN REACHING AGREEMENT ON LANGUAGE, THE REPORT WAS CONSIDERABLY SHORTENED. WE HAVE NOW OBTAINED ON A CONFIDENTIAL BASIS A COPY OF THE FINAL VERSION OF THE REPORT, AND ARE SENDING IT BY AIRGRAM.

3. THE MAJORITY OPINION ARGUES THAT THE EXISTENCE OF MONETARY COMPENSATION AMOUNTS CREATES A "DUAL SYSTEM OF EXCHANGE RATES FOR CURRENT TRANSACTIONS WHICH INTRODUCES DISTORTIONS LEADING TO MISALLOCATION OF RESOURCES AND HINDERS COMPETITION." (COMMENT: THIS SEEMS A SOMEWHAT IRONIC ARGUMENT WITHIN THE CONTEXT OF THE CAP.) THE BASIC OBJECTIVES OF THE COMMISSION'S PROPOSAL (TO REDUCE MCAS THROUGH AUTOMATIC, LOGGED ADJUSTMENT OF "GREEN" EXCHANGE RATES TO MARKET RATES) ARE SUPPORTED. THE OPINION RECORDS SOME DISAGREEMENT ON HOW RAPID AND COMPLETE THE ADJUSTMENT SHOULD BE.

4. THE U.K. DISSENT OPPOSES THE COMMISSION PROPOSAL, AND ANY AUTOMATIC SCHEME FOR REDUCTION OF MCAS, POINTING OUT THE DISADVANTAGES CAUSED BY A RISE IN FOOD PRICES FOR FOOD-IMPORTING COUNTRIES WITH A DEPRECIATED CURRENCY. THE REAL PROBLEM OF THE CAP, IN THE UK VIEW, IS THE PRODUCTION OF AGRICULTURAL SURPLUSES FLOWING FROM EXCESSIVELY HIGH AGRICULTURAL SURPLUSES FLOWING FROM EXCESSIVELY HIGH AGRICULTURAL SUPPORT PRICES.

5. THE AD HOC WORKING PARTY ON ITALY (CHAIRIED BY DE LA GENIERE OF THE BANQUE DE FRANCE) PRESENTED A DRAFT REPORT TO THE COMMISSION ON THE ECONOMIC SITUATION IN ITALY, AND THE ECONOMIC POLICY CONDITIONS TO BE FIXED FOR 1977. (THE REPORT WAS BASED LARGELY ON THE FINDINGS OF THE COMMISSION'S TEAM WHICH VISITED ITALY RECENTLY- REF C.) THERE WAS RELATIVELY LITTLE SUBSTANTIVE DISCUSSION OF THIS REPORT, WHICH WAS ALSO APPROVED AND ISSUED IN FINAL FORM AFTER THE MEETING. WE HAVE OBTAINED A COPY OF THIS REPORT, AND ARE FORWARDING IT BY AIRGRAM. (OUR POSSESSION OF MONETARY COMMITTEE DOCUMENTS SHOULD NOT BE REVEALED.)

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6. THE REPORT ON ITALY BRIEFLY DESCRIBES THE PRESENT ECONOMIC SITUATION THERE, AND REVIEWS GOVERNMENT POLICIES AND COMPLIANCE WITH THE CONDITIONS FOR 1976 AGREED TO BETWEEN THE ITALIAN AUTHORITIES AND THE COMMISSION. THE REPORT NOTES THAT THE BUDGETARY CONDITIONS SEEM LIKELY TO HAVE BEEN RESPECTED ON THE WHOLE, WITH SOME EXCESS EXPENDITURES MAINLY AS A RESULT OF THE FRIULI EARTH-QUAKE, BUT THE TREASURY DEFICIT WITHIN THE 13,800

BILLION LIRE CEILING. (COMMISSION SOURCE HERE EXPRESSES SOME DOUBT AS TO WHETHER THE OUTTURN ON THE BUDGETARY DEFICIT WILL ACTUALLY BE WITHIN THE CEILING.) HOWEVER, THE MONETARY CONDITIONS LIMITS ON THE FINANCING OF THE TREASURY DEFICIT BY THE MONETARY AUTHORITIES, AND THE GROWTH IN TOTAL DOMESTIC LENDING) SEEM LIKELY TO BE BREACHED BY SUBSTANTIAL AMOUNTS.

7. THE REPORT THEN DISCUSSES THE INDICATIVE FORECASTS FOR 1977 AND POLICY GUIDELINES PROPOSED BY THE ITALIAN AUTHORITIES. ASSUMING AN 8 PERCENT GROWTH IN WORLD TRADE VOLUME AND A 10 PERCENT RISE IN THE PRICE OF OIL, EXPORTS (VOLUME) WOULD INCREASE 8 PERCENT, IMPORTS WOULD BE FLAT, PRIVATE CONSUMPTION WOULD FALL SLIGHTLY, PUBLIC CONSUMPTION WOULD RISE BY 1 PERCENT, INVESTMENT WOULD FALL BY 4 PERCENT, AND REAL GDP WOULD SHOW ZERO GROWTH. IN VALUE TERMS, EXPORTS WOULD INCREASE BY 24 PERCENT AND IMPORTS BY 14 PERCENT, RESULTING IN A 800 BILLION LIRE BALANCE OF PAYMENTS SURPLUS ON CURRENT ACCOUNT, AND OVERALL BALANCE AFTER EXTERNAL DEBT REPAYMENTS. TAKING INTO ACCOUNT THE EFFECT OF INCREASES IN INDIRECT TAXES AND PUBLIC SERVICE CHARGES, THE CONSUMER PRICE INCREASE IS PUT AT 20 PERCENT ON AN ANNUAL AVERAGE BASIS, 15 PERCENT DECEMBER TO DECEMBER.

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8. THE ITALIAN AUTHORITIES PROPOSED ECONOMIC POLICY CONDITIONS AS FOLLOWS: (A) CENTRAL GOVERNMENT EXPENDITURE LIMITED TO 51,450 BILLION LIRE, 28 PERCENT OVER 1976;

(B) DEFICIT ON TREASURY TRANSACTIONS LIMITED TO 9,800 BILLION LIRE, 5,000 BILLION LIRE BELOW 1976; (C) MONETARY AUTHORITIES' FINANCING OF TREASURY DEFICIT LIMITED TO 5,000 BILLION LIRE, 4,500 BILLION BELOW THE ESTIMATED 1976 RESULT; (D) GROWTH IN TOTAL DOMESTIC LENDING LIMITED TO 30,300 BILLION LIRE, A 15.3 PERCENT INCREASE COMPARED WITH 19.9 PERCENT ESTIMATED IN 1976, AND ENTAILING A 19.5 PERCENT GROWTH IN M2 AS AGAINST 18.5 PERCENT IN 1976.

9. THE COMMITTEE COMMENTS THAT THE ITALIAN PROPOSALS ON THE TREASURY DEFICIT AND ITS MONETARY FINANCING ARE REASONABLE, BUT ARGUES THAT THE LIMITS ON GROWTH OF EXPENDITURE AND TOTAL CREDIT ARE TOO LAX. THE COMMITTEE ALSO EMPHASIZES THE IMPORTANCE IT PLACES ON SUCCESS IN CHANGING THE INDEX-LINKED WAGE SYSTEM.

10. THE COMMITTEE REPORT NOW GOES TO THE COMMISSION, WHICH IS RESPONSIBLE FOR MAKING A PROPOSAL ON POLICY GUIDELINES TO THE COUNCIL. (THE MONETARY COMMITTEE WILL PROVIDE COMMENTS TO THE COUNCIL ON THE COMMISSION PROPOSAL.) THE FINAL DECISION ON POLICY GUIDELINES, AS WELL AS THE FINAL AUTHORIZATION OF THE \$500 MILLION COMMUNITY LOANS, WAS TO HAVE TAKEN PLACE AT THE CONFIDENTIAL

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DECEMBER 20 FINANCE COUNCIL (REF D). HOWEVER, THESE DECISIONS ARE NOW BEING POSTPONED, AND THE DECEMBER FINANCE COUNCIL CANCELLED (SEE REPTTEL).

11. THE CONSENSUS IN THE COMMITTEE (HEAVILY INFLUENCED BY THE VIEWS OF THE GERMAN REPRESENTATIVES) WAS THAT FINAL DECISIONS ON POLICY GUIDELINES AND THE COMMUNITY LOAN OUGHT TO BE POSTPONED FOR THREE REASONS: (1) IT WOULD BE UNWISE TO TRY TO ESTABLISH POLICY GUIDELINES WHILE KEY ELEMENTS OF THE ITALIAN PROGRAM, IN PARTICULAR, MODIFICATION OF THE SCALA MOBILE, WERE STILL NOT DETERMINED; (2) IT WOULD BE PREFERABLE TO POSTPONE FORMULATION OF EC POLICY GUIDELINES UNTIL THE OUTLINES OF IMF POLICY CONDITIONS WERE KNOWN (IN CONNECTION WITH THE PROSPECTIVE ADDITIONAL ITALIAN DRAWING ON THE IMF); (3) THE ITALIAN RESERVE POSITION HAD BEEN GREATLY STRENGTHENED RECENTLY BY REPATRIATION OF CAPITAL FLOWS UNDER THE AMNESTY PROGRAM, AND WOULD ALSO BE STRENGTHENED BY THE FIAT TRANSACTION. THEREFORE ITALY HAD NO PRESSING NEED FOR ADDITIONAL FUNDS AT THE PRESENT TIME.

12. THE TWO FOREGOING QUESTIONS TOOK UP ALMOST THE ENTIRE MEETING. THE DANISH MEMBERS RAISED THE QUESTION OF EC ATTITUDE TOWARDS CHINESE REPRESENTATION IN THE IMF, BUT

THE COMMITTEE DECIDED THAT THIS WAS A POLITICAL, NOT A TECHNICAL QUESTION. DISCUSSION OF THE U.K. SITUATION WAS POSTPONED, IN VIEW OF THE NEED TO AWAIT THE POLICY DECISIONS TO BE ANNOUNCED SHORTLY.

13. THE NEXT MEETING OF THE MONETARY COMMITTEE IS SCHEDULED FOR JANUARY 25. THE U.K. SITUATION WILL PROBABLY BE DISCUSSED AT THAT TIME. ANOTHER PROBABLE TOPIC FOR DISCUSSION WILL BE THE PROPOSED EUROPEAN EXPORT BANK. (REF E). HINTON

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